subsidies, tariffs, or other trade protections, a government may be able to coax a higher level of output from the high technology industry producing large spillovers and thus could increase that nation's aggregate welfare. Conversely, a foreign country's targeting of high technology sectors through subsidies or protection of home markets could cause the shrinkage of U.S. industries that could have yielded valuable spillovers for the rest of the U.S. economy. By targeting important sectors, the strategic trade theorists conclude, other countries could drive the U.S. from key industries.[24]

This reasoning presents three practical problems. The first is the government's ability to target the right industries. Proponents of strategic trade theory argue that trade policy should encourage strategic industries—which, presumably, are industries that have high value added, linkages with the rest of the economy, and strong growth potential. But if such industries exist, these distinguishing characteristics should be self-evident to the capital market, labor market, and goods market; if no market failure is present, resources will flow into those industries without government intervention. If externalities often arise in high-growth industries, the fact that the private investor might not capture the entire return could be compensated for by speculation. And even if the market failure can be shown to exist, the question then becomes whether, given the scarcity of information about the causes and consequences of externalities, the government is more able to correct the externality than the market. A solution could be for government to subsidize *all* high technology industries, but this kind of general subsidy would be too blunt an instrument to be efficacious and, in any event, is implausible in an era of tighter constraints on government spending. Alternatively, the government could subsidize industries requiring substantial expenditures on research and development, but the burden of ad-

24. *See* KRUGMAN & OBSTFELD, *supra* note 1, at 281–82.

ministering such a policy would be substantial. Any definition of R&D entitled to government subsidy would induce firms to characterize as many costs as possible as R&D expenditures.

The second practical problem of attempting to use strategic trade policies to capture technological spillovers is that no one knows the magnitude of the relevant externalities. Without knowing the size of the external economies, policy makers cannot know the point at which subsidies cease to produce net benefits to society and instead begin to constitute a waste of public resources.

Third, the positive externalities of high technology industries are likely to spill across national boundaries to firms in the other countries. International diffusion of new technological knowledge should be especially likely to occur in telecommunications, where network externalities are commonly hypothesized to arise from higher levels of access to, and usage of, the network.[25] In the age of the Internet and multinational corporations, new technologies developed in Silicon Valley spill over to Bangalore almost as quickly as they do to Route 128 and the Research Triangle. The more that technological spillovers cross national boundaries, the less would be the incentive for any one country to subsidize these industries in the misplaced belief that it can keep all the resulting benefits within its borders.

Is Free Trade Passé?

The preceding discussion suggests that the existence of positive externalities, increasing returns, and oligopoly are factors that require qualification of the assumption of perfect competition that underlies the classical theory of free trade. Should we therefore reject the policy prescriptions of free trade? The

25. LESTER D. TAYLOR, TELECOMMUNICATIONS DEMAND IN THEORY AND PRACTICE 9, 212–40, 348–69 (Kluwer Academic Publishers 1994).

answer is an unequivocal "no." Even though theoretical models can identify potential gains from strategic behavior under certain sets of assumptions, in practice not enough information is available for the government to choose the correct model and implement its policy prescriptions with any reasonable degree of confidence that the outcome will be superior to that which would obtain under free trade.

Summarizing the literature on strategic trade policy, Paul Krugman has observed that, although modest tariffs and subsidies, imposed unilaterally, can benefit the country imposing them, the same models producing those results also suggest that there would be large costs to a trade war and large gains from mutual removal of trade barriers.[26] At a minimum, more empirical work on strategic trade theory needs to be done, and the debate remains unsettled in the academic literature. "One can always do better than free trade," note Elhanan Helpman and Paul Krugman, "but the optimal tariffs and subsidies seem to be small, the potential gains tiny, and there is plenty of room for policy errors that may lead to eventual losses rather than gains."[27] The strategic traders like to quote only the first part of that statement.

In short, free trade represents the best policy prescription given the uncertainty about the welfare implications of alternative trade policies, the difficulty of managing political intervention, and the need to avoid trade wars. "The case for free trade, as brought up to date from 1817," observed the eminent trade theorist Jagdish Bhagwati in 1987, "is . . . alive and well."[28] The same assessment seems justified today and,

26. Paul R. Krugman, *Introduction, in* EMPIRICAL STUDIES OF STRATEGIC TRADE POLICY 5 (Paul R. Krugman ed., National Bureau of Economic Research 1994).

27. ELHANAN HELPMAN & PAUL R. KRUGMAN, TRADE POLICY AND MARKET STRUCTURE 186 (MIT Press 1989).

28. Jagdish Bhagwati, *Is Free Trade Passé After All?, in* POLITICAL ECONOMY AND INTERNATIONAL ECONOMICS 26, __ (Douglas A. Irwin ed., MIT Press

significantly, holds as well under an even newer theory of trade propounded by William J. Baumol and Ralph Gomory, which economists may eventually regard as surpassing strategic trade theory in its ingenuity and analytical rigor.[29]

THE ALLURE AND DANGER OF RECIPROCITY

The proposals to engraft a reciprocity standard onto section 310(b) are emblematic of the general fondness among Congress and regulators for trade policies that condition access to the U.S. market on the extent to which America's trading partners open their markets to American firms.[30] Reciprocity may appeal to one's sense of fair play. But it is a costly indulgence to base policy on this attitude, for American consumers benefit from import competition *whether or not* American firms can export to the markets from which those imports originate. Moreover, even if the apparent fairness of reciprocity is politically satisfying, that condition does not explain why the appeal of reciprocity rises and falls over time, as it has in U.S. trade policy. What, then, explains the rising popularity of reciprocity, as reflected, for example, in efforts in Congress and at the FCC in 1995 to condition foreign investment in U.S. telecommunications firms on market access abroad?

1991).

29. William J. Baumol & Ralph E. Gomory, On Efficiency and Comparative Advantage in Trade Equilibria under Scale Economies (C.V. Starr Center for Applied Economics, New York University, working paper RR # 94-13, Apr. 1994); Ralph E. Gomory & William J. Baumol, Share of World Output, Economies of Scale, and Regions Filled with Equilibria (C.V. Starr Center for Applied Economics, New York University, working paper RR # 94-29, Oct. 1994).

30. *See generally* THE FOREIGN INVESTMENT DEBATE: OPENING MARKETS ABROAD OR CLOSING MARKETS AT HOME? (Cynthia A. Beltz ed., AEI Press 1995).

The growing appeal of reciprocity in U.S. trade policy may stem from the increasing U.S. trade deficit. In 1979–80, the domestic economy witnessed double-digit inflation due to the second oil shock and growing fiscal deficit. The government responded with a tight monetary policy that increased interest rates. The combination of rising interest rates and a growing fiscal deficit led to a massive inflow of capital and an overvaluation of the exchange rate for the dollar. An overvalued dollar and a sluggish European economy after 1982 expanded the U.S. trade deficit. The overvalued exchange rate was ignored until the Plaza Agreement in 1985, when the U.S. finally devalued the dollar.[31]

The devaluation was too late. When it failed to reduce the U.S. trade deficit, some argued that the trade deficit had resulted from U.S. markets being substantially more open than markets in Japan and Europe. Hence the idea gained currency that, to reduce the U.S. current account deficit, the U.S. government had to use both multilateral and bilateral negotiations to open foreign markets—if necessary, using reciprocity backed by the threat of retaliation.

After 1985, the U.S. government used the provisions of section 301 of the Trade Act of 1974[32] and "Super 301" (that is, section 301 of the Omnibus Trade and Competitiveness Act of 1988[33]) to open product markets in other countries, especially Japan.[34] Another instrument increasingly used

31. *See* THOMAS O. BAYARD & KIMBERLY ANN ELLIOTT, RECIPROCITY AND RETALIATION IN U.S. TRADE POLICY 16–18 (Institute for International Economics 1994); YOICHI FUNABASHI, MANAGING THE DOLLAR: FROM THE PLAZA TO THE LOUVRE (Institute for International Economics 2d ed. 1989).

32. 19 U.S.C. § 2411.

33. Pub. L. No. 100-418, 102 Stat. 1107, 1176–79, tit. I, § 1302(a) (codified at 19 U.S.C. § 2420). President Clinton renewed Super 301 by executive order in 1994. Exec. Order No. 12,901, 59 FED. REG. 10,727 (1994).

34. *See* ANNE O. KRUEGER, AMERICAN TRADE POLICY: A TRAGEDY IN THE MAKING 64–67, 78 (AEI Press 1995).

for opening foreign product markets is the voluntary import expansion, which mandates that a country import a specific quantity of a foreign good in a specific industry (usually by setting a minimum import market share) and often is backed by the threat of retaliation.[35] Jagdish Bhagwati has called this development in U.S. trade policy "aggressive unilateralism" because the U.S. unilaterally determined whether a country had violated U.S. trade laws and then announced its judgment, followed by punishment or the threat of punishment.[36]

Critics of reciprocity have argued that a policy of unilateral aggression would more likely close markets than open them and could ignite trade wars. William Cline, for example, argued in the early 1980s: "Such action, which may be called 'aggressive reciprocity' (as opposed to 'passive' reciprocity whereby new concessions are not granted in the absence of reciprocal liberalization), would run a serious risk of counterretaliation, with increased protection and reduced welfare on all sides."[37] Even if reciprocity did not provoke trade wars, critics argued, it would produce trade diversion rather than the trade liberalization that U.S. trade negotiators hoped to achieve: If U.S. firms increased their share of Japan's market through the U.S. government's threats of retaliation, Japan could respond by increasing its share of imports to the U.S. at the expense of other trading partners, such as the Europe Community. In response, Europe would demand an increased quota for its exports to Japan. World trade would depend on the relative bargaining strength of nations rather

35. Jagdish Bhagwati, *Aggressive Unilateralism: An Overview, in* AGGRESSIVE UNILATERALISM: AMERICA'S 301 TRADE POLICY AND THE WORLD TRADING SYSTEM 1, 32-36 (Jagdish Bhagwati & Hugh Patrick eds., University of Michigan Press 1990); *see also* DOUGLAS A. IRWIN, MANAGED TRADE: THE CASE AGAINST IMPORT TARGETS 1 (AEI Press 1994).

36. Bhagwati, *Aggressive Unilateralism: An Overview, supra* note 35, at 2.

37. WILLIAM R. CLINE, "RECIPROCITY": A NEW APPROACH TO WORLD TRADE POLICY? 35-36 (Institute for International Economics 1982).

than on their comparative advantages.

Whatever market opening occurred because of bilateral negotiations would come at the expense of the international trading system. Bhagwati has warned that a bilateral trade policy predicated on threats of sanctions under section 301 could undermine the achievements of the Uruguay Round: "Whether . . . targeting . . . countries would make them more, rather than less, recalcitrant by compounding their sense of unfair U.S. play in trade negotiations remains to be seen."[38] Stanford professor Anne Krueger similarly has warned that "result-oriented aggressive bilateralism has scope for big disruptions of the international trading system and little potential for enhancing the efficient flow of goods and services in the international economy."[39]

Even if foreign countries did not retaliate, is trade policy an efficacious means to correct an adverse U.S. trade balance? After the Plaza Agreement, U.S. government spending persisted and no significant reduction in private spending occurred. Under those circumstances, Bhagwati has observed, expenditure-switching policies such as devaluation fail to produce any appreciable effect on the trade deficit.[40] This assessment comports with the view of other respected economists that the trade balance is fundamentally a macroeconomic phenomenon that is not significantly affected by trade policy.[41] If they are correct, then resorting to trade reciprocity will not reverse an increasing trade deficit.

38. Bhagwati, *Aggressive Unilateralism: An Overview, supra* note 35, at 33.

39. Anne O. Krueger, *Free Trade Is the Best Policy, in* AN AMERICAN TRADE STRATEGY: OPTIONS FOR THE 1990S, at 68, 91 (Robert Z. Lawrence & Charles L. Schultze eds., Brooking Institution 1990).

40. Jagdish Bhagwati, *U.S. Trade Policy at the Crossroads, in* POLITICAL ECONOMY AND INTERNATIONAL ECONOMICS, *supra* note 28, at 35, 39.

41. *See* KRUEGER, *supra* note 34, at 66-67; IRWIN *supra* note 35, at 18-24; FRED C. BERGSTEN & MARCUS NOLAND, RECONCILABLE DIFFERENCES? UNITED STATES-JAPAN ECONOMIC CONFLICT 52-54 (Institute for International Economics 1993).

THE ECONOMICS OF RESTRICTING FOREIGN DIRECT INVESTMENT IN TELECOMMUNICATIONS

Does it benefit the U.S. to open its markets to foreign investment even when American firms do not receive the same treatment from foreign countries? No, say proponents of reciprocity. They argue that the U.S. should use the offer to reduce its restrictions on foreign investment as a bargaining chip to induce other nations to lift their restrictions on American direct investment in their telecommunications industries.[42] Yet proponents of reciprocity for section 310(b) noticeably fail to cite economic evidence that reciprocal treatment has successfully acted in the past or will successfully act in the future to lower barriers to U.S. direct investment in overseas telecommunications markets.

Market Access Abroad

As noted earlier in the case of trade in goods, it is equally likely that a reciprocity policy will cause one's trading partner to harden its position rather than reduce barriers. Similarly, the outright elimination of section 310(b) would deny foreign governments a convenient excuse for limiting the extent of U.S. direct investment in their telecommunications firms. For example, Sam Ginn, the chief executive officer of AirTouch Communications, one of the largest cellular telephony service providers in the U.S., observed in 1994:

> [W]hen AirTouch goes into a foreign cellular

42. *E.g.*, ERIK OLBETER & LAWRENCE CHIMERINE, CROSSED WIRES: HOW FOREIGN POLICIES AND U.S. REGULATORS ARE HOLDING BACK THE U.S. TELECOMMUNICATIONS SERVICES INDUSTRY (Economic Strategy Institute 1994); *Hearing on S. 253 before the Subcom. on Telecommunications of the Sen. Com. on Commerce, Science, and Transportation*, 104th Cong., 1st Sess. (Mar. 21, 1995) (testimony of Eli M. Noam).

> consortium, we bring the technology, the skills, the operating systems, the billing systems, and the training, and my local partner is there to run political interference for the license. What I hear time after time is, "You can only own up to 25% because that's the limitation that your government places on our companies."[43]

The ability of foreign governments to raise this objection disproportionately harms U.S. firms, Ginn argues, "because the most effective players in the international expansion of wireless today are U.S. companies."[44] The 25 percent de facto limitation on ownership causes AirTouch to resort to a decidedly inferior structure for the ownership and control of the foreign consortium in which the U.S. company is investing:

> Because I cannot own a share of a company in another country greater than 25%, what I have to do is negotiate contractually for board representation. I can then fill certain slots in the management team and veto the business plan. Often, one cannot obtain these conditions through negotiation.[45]

43. Sam Ginn, *Restructuring the Wireless Industry and the Information Skyway*, 4 J. ECON. & MGMT. STRATEGY 139, 144–45 (1995) [hereinafter *Information Skyway*].

44. *Id.* at 145. "There are almost no other players. The active companies include BellSouth, AirTouch, U S West, and Southwestern Bell." *Id.*

45. *Id.* On another occasion, Ginn has testified:

> Foreign ownership restrictions limit our opportunities. U.S. restrictions inhibit our ability to invest and expand abroad. Foreign governments tend to mirror U.S. government treatment of their firms doing business in the U.S. Therefore, U.S. restrictions on foreign investment for wireless telecommunications create difficulties for U.S. firms trying to

What Ginn describes is plainly an unintended consequence overseas of the foreign ownership restrictions in U.S. telecommunications law. It has two economic implications that are detrimental to U.S. interests.

First, it increases financial risk for U.S. firms investing in foreign markets. A firm like AirTouch cannot monitor its investment as effectively as it could in the absence of ownership restrictions being placed on them. Although chapter 4 explained that the problems of ownership and control also arise under section 310(b) in the structuring of foreign investments in U.S. telecommunications firms, the problem is more severe when the investor is an American firm and the recipient of the investment is in another country. Even with the prospect of new telecommunications legislation, the U.S. market and regulatory environment are surely more settled than those of virtually any other nation. The reason is that the U.S. has not undergone a privatization and deregulation of a government-owned telecommunications monopoly. Many countries that are the targets of U.S. direct investment are in the midst of just such monumental regulatory transitions. Changes of such magnitude present enormous hazards and opportunities—which is to say, that the quality of managerial decisions will influence the shareholder value more than would be the case in a firm with a mature product market and regulatory environment.[46]

invest abroad.

Hearings Before the Subcomm. on Commerce, Trade and Hazardous Materials of the House Commerce Committee, 104th Cong., 1st Sess. (Mar. 3, 1995) (testimony of Sam Ginn, Chairman and Chief Executive Officer, AirTouch Communications) [hereinafter *Ginn Testimony*].

46. An analogous situation in the U.S. involved the growing returns to managerial decision making following the deregulation of railroads. *See* Ann F. Friedlaender, Ernst R. Berndt & Gerard McCullough, *Governance Structure, Managerial Characteristics, and Firm Performance in the Deregulated Rail Industry*, 1992 BROOKINGS PAPERS ON ECON. ACTIVITY: MICROECONOMICS 95.

The second economic implication of the situation that Ginn describes is that it implicitly transfers rents from U.S. investors to domestic investors in the foreign market. The value of AirTouch's investment in the Portuguese wireless market, for example, is not limited to the U.S. firm's supply of financial capital. As Ginn makes clear, U.S. wireless companies bring technological and managerial expertise, and those resources have in relative terms far fewer alternative sources of supply than the necessary financial capital—which, after all, is entirely fungible and can be raised through competing investment and commercial banks around the world. Conceivably, AirTouch could separately contracts with the foreign consortium to supply such intellectual and managerial capital; but that alternative would be cumbersome, have high transactions costs, and be potentially regarded by foreign partners as overbearing. Consequently, AirTouch is limited to capturing at most 25 percent of the value created by the consortium's use in Portugal of AirTouch's unique intellectual and managerial capital. Stated differently, AirTouch must supply 25 percent of the financial capital and essentially 100 percent of the intellectual and managerial capital so that it can have the opportunity to earn 25 percent of the residual net cash flows of the foreign consortium.

Not surprisingly, Ginn argues that, "from the standpoint of U.S. companies trying to penetrate these world markets," it is important to reform section 310(b).[47] The potential gains are substantial:

> The Japanese government has been willing to open its wireless telecommunications markets to our investment . . . . In my opinion, the Japanese government would be open to permitting greater levels of foreign investment in wireless

47. Ginn, *Information Skyway, supra* note 43, at 145.

> telecommunications if U.S. policymakers liberalized our limits on Japanese investment. This would allow companies like ours to increase our equity in a very attractive market.[48]

Although reciprocity is one approach, it seems more plausible, in light of the difficulty of predicting the strategic responses of other governments, that reducing U.S. investment barriers will actually set in motion a political dynamic in foreign countries that causes more liberal investment policies there. As Ginn notes, the U.K.'s experience with unilateral reduction in barriers to foreign direct investment in its telecommunications market provides actual evidence that such an approach can benefit domestic interests:

> The United Kingdom provides an example of an alternate approach. Its government has declared unilateral openness. There are no foreign ownership restrictions. As a result, there has been an influx of new competitors and the creation of a very competitive market. Their economy has ample capital investment, their wireless market new service offerings and broad partnerships.[49]

In short, the prescriptions for reciprocity in foreign investment policies are based on questionable assumptions concerning the strategic response of other nations. A policy of reciprocity could easily backfire and produce results that are inferior to what has *actually been observed* to result from unilateral liberalization of restrictions on foreign direct investment in telecommunications.

48. *Ginn Testimony, supra* note 45.
49. *Id.*

The potential for a U.S. policy of reciprocity to provoke other countries can be seen in a January 1995 letter from Horst G. Krenzler, the Director-General I of the European Commission, to an American business group, the EC Committee of the American Chamber of Commerce in Belgium, that had expressed concern over suggestions in late 1994 that the EC may impose foreign ownership limits in telecommunications.[50] The Director-General's letter was blunt:

> . . . I was particularly concerned with the statement made by the EC Committee in its position paper that there is no need to overstate the reach of foreign ownership limits in US legislation applying to the telecommunications sector. The EC Committee argues that these limits, and particularly those foreseen under [section 310], do not affect the whole range of telecommunications services in the US, in particular those that do not rely on radio facilities, those provided over the infrastructure of another operator (i.e., resold) or private services.
>
> I could not share such an interpretation on the reach of the restrictions imposed under Section 310 of the US Communications Act . . . .
>
> In practice, since most carriers rely on the use of radio transmission stations, satellite earth stations and in some cases, microwave towers, the majority of foreign-owned carriers are unable to compete in the long distance market

50. Letter from Horst G. Krenzler, Director-General I, European Commission, to Mr. Oliver, The EC Committee of the American Chamber of Commerce in Belgium, Jan. 18, 1995.

> (the local market being subject to the monopoly of the Bell Operating Company in most States), and only through a minority share holding in the mobile market (AMSC, a consortium comprising most of the US companies involved in the sector, enjoys exclusive monopoly rights for the provision of US mobile satellite services, thus excluding any foreign competition).[51]

The Director-General also disputed that the FCC had exercised or would exercise its discretion under section 310(b) in a manner that would lessen the practical impediment that the statute presented:

> The EC Committee seems also to consider that there is sufficient flexibility in US legislation not to prevent the required foreign investment in the sector and that, in the specific case of indirect ownership, the FCC would be in a position to waive or extend the limits to foreign participation if it finds that this would be in the public interest. *The FCC, however, rarely uses this possibility. I would argue, on the contrary, that there is a lack of principles on which to base FCC decisions, and therefore insufficient predictability to justify foreign investment.*[52]

Chapter 4 showed that, as Director-General Krenzler correctly noted, the principles used by the FCC to waive application of section 310(b)(4) are utterly amorphous and thus amenable to any result that the FCC desires in a given case. The Director-General also expressed concern that American proposals for

51. *Id.* at 1-2.
52. *Id.* (emphasis added).

reciprocity "could . . . endanger[] progress in current multilateral negotiations."[53] That concern is well founded. As we shall see shortly, if the FCC's waiver decisions under section 310(b)(4) have lacked consistency and logic, then one can only expect that experience to be repeated in a more byzantine manner if the FCC were authorized to enforce a new foreign ownership restriction predicated on bilateral reciprocity.

Capturing Economic Rents and Technological Spillovers in the U.S.

In his important article, Steven Globerman has analyzed how restrictions on foreign ownership of telecommunications firms may serve other economic objectives besides the securing of reciprocal treatment of direct investment in the foreign firm's home market.[54] Along the lines of the oligopoly rent arguments made in strategic trade theory, one can theorize that economic rent may accrue to "first mover" advantages or the establishment of early incumbency in an industry. The incumbent firm may use its status to establish a dominant position that may last for years. Entry barriers like section 310(b) may facilitate this establishment of incumbent advantage and reserve for domestic owners of firms (rather than foreigners) the privilege of capturing economic rents.[55]

The argument does not withstand scrutiny, however, because restrictions on foreign investment in telecommunications are, Globerman argues, the least desirable means to capture economic rent in that industry because "they encourage production by less efficient domestic suppliers at the expense of more efficient foreign suppliers."[56] Only extraordinary circumstances, such as largely undeveloped markets or

53. *Id.* at 2.
54. Globerman, *Foreign Ownership, supra* note 2, at 23–25.
55. *Id.* at 23.
56. *Id.* at 24.

markets with high anticipated growth (such as personal communications services, or PCS), could possibly justify investment barriers.[57] In the case of the U.S. domestic telecommunications market, the first condition plainly is not satisfied. Few rural markets in the U.S. are undeveloped. With respect to the second condition, anticipation of high growth is better reserved for the emerging markets in Asia, Latin America, and eastern and central Europe.

Globerman suggests other means, less damaging to the general welfare than restrictions on foreign direct investment, by which the host government could capture economic rent. If the foreign firm is known to operate more efficiently, then the host government could auction to the foreign firm the rights to supply telecommunications services.[58] Alternatively, the host government could tax away the economic rent earned by suppliers, although this policy would impose a deadweight loss on the host economy.[59]

Another possible economic rationale that Globerman identifies for foreign ownership restrictions in telecommunications is the existence of positive externalities along the lines hypothesized by the strategic trade theorists.[60] U.S. carriers may be more likely than foreign carriers to carry out their research and development in the U.S.; if so, then more spillovers benefits arguably would accrues in the U.S. if investment by foreign carriers were restricted.

This rationale, Globerman notes, is subject to two large caveats. The first is that technological externalities result from the diffusion of technology, and not merely from the

57. *Id.* at 23.

58. *Id.* at 23 n.8 (citing Oliver E. Williamson, *Franchise Bidding for National Monopolies in General and with Respect to CATV*, 7 BELL J. ECON. 73 (1976)).

59. *Id.* at 24.

60. *Id.*

location of R&D activities.[61] Globerman argues that

> the introduction and spread of already existing technology will generate external benefits for consumers and related suppliers. The potential entry of foreign suppliers should be a spur to existing domestic suppliers to adopt best-practice technology in a timely fashion, while the actual entry of more technologically advanced foreign suppliers will directly promote the diffusion of technology in the domestic industry.[62]

Globerman's second caveat is that "foreign ownership restrictions in any one country almost certainly retard technological changes in that country to the extent that they beget similar restrictions in other countries."[63] Should such retaliation arise, it would be especially costly in the specific context of telecommunications services because of the network externalities that one would expect to observe on an international basis.

Globerman concludes that "constraining foreign ownership in any segment of the telecommunications industry does not seem to be good public policy. Either such constraints will not contribute to the realization of their putative objectives, or there are equally effective instruments that will do less damage to the competitive process."[64] We will now examine proposals to amend or interpret section 310(b) to incorporate the

61. *Id.*

62. *Id.* Similarly, Sam Ginn of AirTouch has testified before Congress: "Foreign investment in U.S. companies is also directly beneficial to the U.S. national interest. Foreign investment provides additional capital available for R&D and the build-out of networks, jobs for American workers, new technology, and exposure to skills and best practices we can use to improve our methods of doing business." *Ginn Testimony, supra* note 45, at 4.

63. Globerman, *Foreign Ownership, supra* note 2, at 24.

64. *Id.* at 28.

principle of bilateral reciprocity and consider whether those proposals are likely to realize their objectives of opening foreign markets to investment by U.S. firms.

MAKING SECTION 310(b) A RECIPROCITY TEST

In 1995, both the Senate and House telecommunications deregulation bills, S. 652 and H.R. 1555, contain provisions to amend section 310(b) to embody the concept of bilateral reciprocity.[65] Also in 1995, the FCC proposed a rule that would engraft a reciprocity standard onto the public interest determination that the agency makes when enforcing the existing section 310(b).[66] These proposals to alter the foreign ownership restrictions are inferior to outright repeal of section 310(b), which Representatives Michael Oxley and Rick Boucher proposed unsuccessfully in 1995.[67] But such proposals nonetheless are politically attractive for the reasons that reciprocity proposals generally find favor in Washington.

THE SENATE BILL

In 1995, the Senate passed legislation that would subject foreign investment in U.S. radio licensees to a test bilateral reciprocity if the investment were to exceed the benchmarks contained in section 310(b). The provision was poorly conceived from the start and, even after considerable revision, remained highly problematic in the form that passed the Senate.

65. S. 652, § 105, 104th Cong., 1st Sess. (1995); H.R. 1555, § 302, 104th Cong., 1st Sess. (1995).

66. *Market Entry and Regulation,* 10 F.C.C. Rcd. 5256, *supra* note 3.

67. H.R. 514, 104th Cong., 1st Sess. (1995); *see also* 141 CONG. REC. H241 (daily ed. Jan. 13, 1995).

The Discussion Draft of the Senate's 1995 Telecommunications Bill

On January 31, 1995, Senator Larry Pressler, chairman of the Telecommunications Subcommittee of the Senate Commerce Committee, circulated for public comment his "Telecommunications Competition and Deregulation Act of 1995," a draft bill to rewrite the Communications Act of 1934.[68] As midnight approached on January 30, the Senate staff still did not have language concerning reform of section 310(b). As a "place holder," one staffer who had worked on the telecommunications section of the 1988 Trade Act—which addressed trade in telecommunications equipment but not foreign direct investment—suggested that the provision in the 1988 legislation be borrowed.[69] The suggestion was accepted and the draft bill included a provision that would amend section 310 by adding a new subsection 310(f). As we shall see, however, the statutory language creates anomalies and perverse economic incentives when applied to flows of financial and managerial capital rather than flows of goods. Unfortunately, those oddities, to the extent that they would reduce the likelihood of foreign direct investment in U.S. telecommunications carriers, appear in retrospect to have made the borrowed language unexpectedly appealing to protectionists in the Senate.

The new subsection would make section 310(b) inapplicable in cases where reciprocal policies among two countries permitted more liberal foreign direct investment in telecommunications than the 25 percent level mentioned in section 310(b). Proposed subsection 310(f)(1) stated that section 310(b)

68. Telecommunications Competition and Deregulation Act of 1995 (discussion draft, Jan. 31, 1995).

69. Interview with Keith E. Bernard, Vice President of International and Regulatory Affairs, Cable & Wireless, Inc. (Aug. 30, 1995).

> shall not apply to any license held, or for which application is made, after the date of enactment of the Telecommunications Act of 1995 with respect to any alien (or representative thereof), corporation, or foreign government (or representative thereof) if the United States Trade Representative has determined that the foreign country of which such alien is a citizen, in which such corporation is organized, or in which such foreign government is in control provides mutually advantageous market opportunities for broadcast, common carriers, or aeronautical enroute or fixed radio station licenses to citizens of the United States (or their representatives), corporations organized in the United States, and the United States Government.[70]

This provision was the carrot: If, for example, the U.K. allowed 100 foreign ownership of wireless common carriers (such as providers of cellular telephony), then a U.K. investor could buy 100 percent of a U.S. cellular carrier.

The January 31 draft also contained a stick, known as the "snapback for reciprocity failure."[71] Proposed section 310(f)(2) provided:

> If the United States Trade Representative determines that any foreign country with respect to which it has made a determination under paragraph (1) ceases to meet the requirements for that determination, then—
>
> (A) subsection [310](b) shall

70. *Id.* § 105, at 39, lines 4-19 (proposed 47 U.S.C. § 310(f)(1)).
71. *Id.* at 39, line 20 (proposed 47 U.S.C. § 319(f)(2)).

> apply with respect to such aliens, corporations, and government (or their representatives) on the date on which the Trade Representative publishes notice of its determination under this paragraph, and
>
> (B) any license held, or application filed, which could not be held or granted under subsection [310](b) shall be withdrawn, or denied, as the case may be, by the Commission under the provisions of subsection [310](b).[72]

Despite the plethora of jargon and acronyms used in the daily parlance of telecommunications law, the term "snapback" was entirely foreign to lawyers specializing in the regulation of telecommunications services and facilities. Their unfamiliarity underscored the fact that the Senate language was a square peg in a round hole—a provision drafted to regulate trade in telecommunications equipment now being used to regulate trade in financial and managerial capital. "Snapback" meant something to international trade lawyers, but not to telecommunications lawyers.

Given the forced nature of the Senate language, it is not surprising that the snapback provision is deeply problematic for several reasons. First, key words do not match the existing terminology of telecommunications law. The FCC does not "withdraw" a license or an application. The agency can revoke a license or decline to renew it, or it can refuse to grant an application for a license. But the withdrawal of an application is something that an *applicant* would have to do, and there is no concept at all corresponding to a licensee "withdrawing" a license already granted to him.

72. *Id.* at 39 line 21 to 40 line 10 (proposed 47 U.S.C. § 310(f)(2)).

Second, the snapback provision in proposed section 310(f)(2)(B) would be draconian and runs counter to common sense. Suppose that Canada allows 33 percent foreign ownership and that Bell Canada is therefore allowed to purchase 33 percent of a U.S. cellular telephone company. Suppose that the Canadian government subsequently reduces its foreign ownership limit to 25 percent. The proposed section 310(f)(2)(B) would cause Bell Canada to have the license for the cellular carrier "withdrawn . . . or denied." The remedy, in other words, is not that Bell Canada would have to reduce its ownership of the cellular company to 25 percent; rather, Bell Canada would forfeit its license entirely.

There is an economic rationale that one could impute to the harshness of the snapback provision. (Whether the statutory language was ever intended to effect this purpose is another matter.) It is widely recognized in economic theory that commitments made in bargaining situations influence the behavior of other actors only to the extent that the person making such commitments is credibly bound (by himself or others) to honoring them.[73] In effect, the forfeiture feature of proposed section 310(f)(2)(B) would make Bell Canada the guarantor of the foreign investment policies of the Canadian government. In the jargon of economics and game theory, the Canadian government would have made a "credible commitment," and Bell Canada's investment in the U.S. cellular licensee would become a "hostage." The Canadian government would know that the consequences of lowering its foreign ownership limit, having once raised it, would be that Bell Canada's investments (indeed *all* Canadian investments) in U.S. radio common carriers that exceeded 25 percent ownership of the carrier would be lost. Consequently, the Canadi-

73. *See, e.g.*, PAUL R. MILGROM & JOHN ROBERTS, ECONOMICS, ORGANIZATION AND MANAGEMENT 131 (Prentice-Hall 1992); OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM 167 (Free Press 1985); THOMAS C. SCHELLING, THE STRATEGY OF CONFLICT (Oxford University Press 1960).

an government would have a strong incentive not to lower the foreign ownership.

There are four insurmountable problems with this argument that cause one to suspect that the forfeiture provision was the result of sloppy draftsmanship rather than a subtle attempt to create binding commitments to reductions in barriers to foreign investments. First, if the U.S. can draft such a provision, so can other nations. Any firm, U.S. or foreign, would be exceedingly reluctant to invest in a country that permitted the expropriation of one's investment without cause. Thus, the prospect of retaliatory enactment of snapback laws in other nations would likely *reduce* the amount of foreign direct investment both in the U.S. and in the nations where U.S. telecommunications firms would like to invest. Second, the prospect that Canada could never lower its foreign ownership limit without sacrificing Canadian investments in wireless in the U.S. would create a powerful incentive for Canada never to raise its foreign ownership limits in the first place. Third, knowing of this dynamic, the Canadian government could evade the bite of the snapback provision by secretly notifying Canadian companies with wireless investments in the U.S. that the Canadian government intended to lower the foreign ownership ceiling and advising those companies to disinvest to the 25 percent level in the U.S. before the Canadian government announced its new policy. Fourth, a company cannot surrender part of a license. How could a company partly owned by Canadian investors have its license "withdrawn" or "denied" unless the other shareholders—that is, the company's *American* shareholders—also were made to forfeit their license at the same time. But if that happened, U.S. companies would have a strong incentive *never* to accept any foreign investment in excess of 25 percent—for if they did, all the shareholders of U.S. citizenship would be turned into guarantors of the foreign ownership policies of the Canadian government. In short, the snapback provision in S. 652 is poorly conceived and drafted, and disastrous in the counterproductive incentives it would create for foreign direct investment.

On February 14, 1995, Senator Ernest Hollings of South Carolina, the ranking minority member of the Senate Commerce Committee, circulated a Democratic draft bill in response to Chairman Pressler's.[74] It contained no provisions addressing foreign ownership.

The Foreign Ownership Provisions in S. 652

On March 29, 1995, Senator Pressler introduced S. 652, the revised Telecommunications Competition and Deregulation Act of 1995, which reflected certain provisions sought by Senator Hollings. In its preamble, the bill stated: "The efficient development of competitive United States communications markets will be furthered by policies which aim at ensuring reciprocal opening of international investment opportunities."[75] The foreign ownership provision was substantially the same as that in the January 31 draft bill.[76] There were five differences between the two bills.

First, whereas the January 31 draft bill encompassed "any license," the March 29 bill narrowed proposed section 310(f) to "any common carrier license." The practical import of this change was to exclude radio and television broadcast licenses from the amendments to section 310(b).

Second, the March 29 bill changed, from the U.S. Trade Representative to the FCC, the government body that would make the determination of foreign market access.

Third, the market-access determination was redefined. In the January 31 discussion draft, it had been whether the

74. Universal Service Telecommunications Act of 1995 (staff working draft, Feb. 14, 1995).

75. S. 652, § 5(14), 104th Cong., 1st Sess. (1995).

76. *Id.* § 105 (creating 47 U.S.C. § 310(f)).

foreign provides "mutually advantageous market opportunities for broadcast, common carriers, or aeronautical enroute or fixed radio station licenses." In the March 29 bill, the test became whether the foreign government provides "equivalent market opportunities for common carriers." Thus, the March 29 excluded broadcast licenses from the reciprocity test, along with aeronautical enroute or fixed radio station licenses.

Fourth, the March 29 bill added the following sentence to the end of proposed subsection 310(f)(1): "The determination of whether market opportunities are equivalent shall be made on a market segment specific basis." The committee report gave a curious interpretation of this sentence:

> The FCC must enforce the provision on a market segment by market segment basis. For instance, if a foreign company wishes to acquire a common carrier license, the openness of the foreign market to U.S. communications equipment manufacturers is not the relevant market to examine. If a foreign company wishes to acquire a common carrier license, the FCC should examine the openness of the foreign country's common carrier market to U.S. investment.[77]

It is difficult to take this report language at face value, for it imparts so lax an interpretation to the statute that the concept of a "market segment" becomes larger than that of simply a "market." The report's interpretation could conceivably allow comparisons of cellular telephony in one country with long-haul fiber-optic transport in another. A more literal reading of the statutory text suggests that the Senate Commerce Committee was creating something closer to a "mirror reciprocity"

77. S. REP. NO. 23, 104th Cong., 1st Sess. 34 (1995).